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401(k) Forfeiture Lawsuits Push Employers to Revisit Plan Terms

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The surge of litigation challenging how companies handle forfeited 401(k) money is spurring some employers to consider changing how their plans operate in hopes of cutting off a key argument plaintiffs have relied on.

About 100 employers have faced suits over the past three years for using the 401(k) money forfeited by departing workers to fund their own employer plan contributions, instead of using it to lower the administrative expenses paid by workers.

Many cases center on plan language giving employers discretion over how to use forfeited funds. Workers argue that a company commits fiduciary breach when it chooses to use this money to benefit itself instead of its employees.

As attorneys wait for this theory to be tested in the federal appeals courts, some employers are mulling whether to amend their 401(k) plan documents to specify how forfeitures should be used and remove any discretion that could fuel a fiduciary breach claim under the Employee Retirement Income Security Act.

“We understand some plan sponsors have considered or adopted plan amendments designed to reduce fiduciary discretion and limit plan flexibility,” said Andy Banducci, senior vice president for retirement and compensation policy at the ERISA Industry Committee.

Recent complaints filed against US Foods Inc., Citizens Financial Group Inc., and United Rentals (NA) Inc. each claim the relevant plan was amended to mandate that forfeitures go toward employer contributions.

ERISA requires that benefit plans be administered according to their express terms, said Jillian Gordon Foerster, an attorney at Dykema Gossett PLLC who advises companies on employee benefit issues. When a plan is amended to “hardwire” how forfeitures will be used, “it makes it more difficult, at least under current legal theory, for plaintiffs to argue that it’s a breach of fiduciary duty to use forfeitures in that manner,” she said.

Mandate vs. Discretion

Most forfeiture cases that have advanced to early court rulings — about 60 so far — have included allegations that the relevant plan document gave the employer discretion over forfeitures. Judges have sided with companies more often than employees, but more than a dozen cases have advanced.

In the handful of cases involving plans that specify forfeitures be used for employer contributions, defendants have been largely successful in fending off claims they should have used the money differently. Nordstrom Inc., BAE Systems Inc., and Liberty Mutual Group Inc. each secured dismissal after judges said their plan documents didn't afford them discretion to use forfeitures in the manner urged by workers.

A case against National Medical Care Inc. went the other way, with US Judge William G. Young writing that "merely following the plan document" doesn't necessarily "insulate a fiduciary from ERISA liability."

However, judges on both the Third and Ninth circuits asked questions suggesting that plan amendments eliminating forfeiture discretion may work to limit liability during oral arguments in pending cases involving HP Inc., Siemens Corp., and Honeywell International Inc.

Follow the Plan

Companies sensitive to this risk could consider adopting a "forfeiture hierarchy" that clearly specifies how forfeitures will be used and in what order, Foerster said. An employer that wants to use forfeitures to fund plan contributions could consider writing that into their plan documents as a mandate, thereby eliminating the discretion fueling much of the litigation, she said.

"Eliminating the ability by the terms of the plan to have that discretion — that helps, we believe," Foerster said.

Employers that rely on 401(k) plan documents drafted by outside vendors and pre-approved by the Internal Revenue Service are beginning a new two-year cycle for updating those plans and may revisit how forfeitures are handled during that window, said Michelle Ueding, a partner with Kutak Rock LLP.

According to Ueding, employers should ensure their plan terms are clear and followed.

"If a plan sponsor has always used forfeitures the same way and the plan document provides them flexibility to do something else, then removing the flexibility they're not using makes sense," she said. "On the other hand, if the plan sponsor has agreed to pay not only contributions but certain plan expenses, and it likes the flexibility to be able to choose which one, then documenting this direction from the plan sponsor to the fiduciary is an approach to manage risk."

Eric W. Gregory, a member of Dickinson Wright PLLC and co-chair of its employee benefits group, also emphasized the importance of having clear plan terms that are carefully followed.

“If you’re following the terms of the plan document, and those terms are permissible, it’s hard for a plaintiff to allege a fiduciary breach,” Gregory said. “We live in the United States of America, where anybody can sue anybody for anything at any time, but if you’re doing all those things, it makes it less likely.”

‘Knee-Jerk Reaction’

Forfeiture-centered plan amendments aren’t yet “sweeping the employer community,” but it’s something people are thinking about, said Lynn Dudley, senior vice president for global retirement and compensation policy at the American Benefits Council. Plan amendments involve multiple business and compliance considerations and aren’t typically done at the “snap of a finger,” she said.

Amendments might be a reasonable choice for “risk-averse” employers in certain jurisdictions, but there are multiple factors to consider, said Andrew Oringer, a partner with Wagner Law Group.

The Trump administration has voiced support for employers in several forfeiture suits, and there are multiple jurisdictions where these cases are “having trouble proceeding,” he said.

“I don’t think it’s at all a no-brainer to be abandoning the historical approach as a knee-jerk reaction to these lawsuits,” Oringer said.

Some employers may be awaiting guidance from the federal appeals courts, which haven’t yet assessed this legal theory. Appeals are pending in the Second, Third, Fourth, Fifth, Sixth, and Ninth circuits.

Plan amendments may pick up once the federal appeals courts weigh in, Foerster said. “That may make us feel like this is something we’ve got to do and bang the drum to make sure our clients pay attention.”

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